In the Supreme Court of the United States

OCTOBER TERM 1944.

No. 342.

In the Matter of
THE HIGBEE COMPANY, *Debtor* } Bankruptcy No. 36,119.

ROBERT R. YOUNG,
Petitioner,

vs.

THE HIGBEE COMPANY,
WILLIAM W. BOAG and
J. F. POTTS,
Respondents.

BRIEF OF PETITIONER.

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BRIEF OF PETITIONER.

(A) REPORT OF OPINIONS BELOW.

The opinion of the District Court was not published. It appears in the record at page 252. The order of the Circuit Court of Appeals approving the judgment of the District Court is reported at 142 Fed. (2) 1004. It appears in the record at page 264.

(B) JURISDICTIONAL GROUNDS.

On October 9, 1944 this Court granted Petition for Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit. The Writ was sought pursuant to the provisions of Judicial Code Section 240, as amended (28 U. S. C. A. 347).

(C) STATEMENT OF THE CASE.

This is a controversy arising out of the corporate reorganization proceedings of The Higbee Company pursuant to Chapter X of the Bankruptcy Act. Petitioner was, at the time of the transaction involved, a holder of First Preferred Stock of The Higbee Company, Debtor. Petitioner still holds the securities which pursuant to the Plan of Reorganization were issued in respect of those shares.

Respondents Potts and Boag owned 250 shares and 10 shares, respectively, of the First Preferred Stock of Higbee. They organized and were members of a Preferred Stockholders Committee and objected to the Plan of Reorganization for Higbee, principally upon the ground that certain large claims (generally referred to as the "junior indebtedness") which were asserted against Higbee by one C. L. Bradley and one J. P. Murphy, were invalid, or should be materially reduced, and that the distribution of new securities to the junior indebtedness, which was provided by the Plan, was excessive and, therefore, unfair to preferred stockholders. The District Court confirmed the Plan, and Potts and Boag, under the circumstances which will be described in more detail below, appealed to the Circuit Court of Appeals for the Sixth Circuit from the order of confirmation.

The litigation, involving the contentions of Potts and Boag, took place over a period of almost four years—from 1938 to 1942. During this period first as the "New Preferred Stockholders Committee" and later as the "Independent Preferred Stockholders Committee," Potts and Boag openly declared themselves to be representing and acting in the interests of the preferred stockholders generally of Higbee. Representations of this character were made to the Court and by circularization to the stockholders.

Messrs. C. L. Bradley and J. P. Murphy were Directors of Higbee, and Bradley was its President. As the legal owners of the junior indebtedness, they had filed claims against Higbee and were, naturally, interested in receiving the benefit of the liberal treatment which the Plan accorded to these claims.

Obviously, a direct conflict of interest between Potts and Boag, who were representing the interests of the preferred stockholders, and Bradley and Murphy, who were pressing their individual interests, was created.

On March 7, 1942 Bradley and Murphy, being anxious that the Plan be approved, paid Potts and Boag $115,000 for their shares which then had a current market value of approximately $15,000. By an express provision in the contract of sale Bradley and Murphy succeeded to the rights of Potts and Boag in the appeal (R. 223). They forthwith caused the dismissal of the appeal and consequent final confirmation of the Plan of Reorganization, thus avoiding a determination by the Circuit Court of the merits of the questions raised by the appeal. Potts himself characterized the transaction as "selling the appeal." (R. 188)

It is the contention of Petitioner that this transaction was wrongful because it was done by persons occupying a fiduciary capacity, and because it deprived their beneficiaries of an adjudication of important legal questions pertaining to substantive rights. Consequently an order was prayed below directing Potts and Boag to turn over to The Higbee Company for the sole benefit of its first preferred stockholders the $100,000 bonus which they received, that being the difference between the fair market value of the securities sold to Bradley and Murphy and the price received.

QUESTIONS PRESENTED.

1—After Potts and Boag had represented to the Court and to the Higbee preferred stockholders that they were acting as a committee in the interests of all preferred stockholders, can they thereafter accept and retain for themselves individually a $100,000 consideration for permitting the dismissal of an appeal which they had taken from a decree confirming the Amended Plan of Reorganization of The Higbee Company?

2—Should Potts and Boag be required to pay over to The Higbee Company for its First Preferred Stockholders the aforesaid $100,000 consideration which they received for permitting the dismissal of the appeal?

(D) SPECIFICATION OF ERRORS.

1. The Lower Court erred in failing to hold that under the admitted facts Potts and Boag violated their obligations to the preferred stockholders of The Higbee Company by "selling" their appeal from the order of the District Court which had approved the Higbee plan of reorganization.

2. The Lower Court erred in failing to order Potts and Boag to pay over to The Higbee Company for the benefit of its preferred stockholders the difference between the fair market price of their 260 shares of First Preferred Stock of The Higbee Company on March 7, 1942, and the price which Bradley and Murphy paid Potts and Boag for said shares.

3. The Special Master erred in making and the District Court erred in approving Master's findings Nos. 1, 2, 3, 4, 5, 6, 7, 17, 23, 39, 40, and 41, as there is no evidence whatever in the record in support thereof or bearing thereon.

(E) ARGUMENT.

SUMMARY OF ARGUMENT.

(1) The litigation instituted by Potts and Boag was analogous to a representative suit, the proceeds of which in this instance should be paid to The Higbee Company for the benefit of the stockholders whom they were supposed to be representing, the settlement of the litigation being fundamentally the same as a successful prosecution thereof.

(2) Members of a Stockholders' Committee owe fiduciary obligations to the stockholders they represent and may not change their status or abandon the interest of those they represent, at least without notice.

THE FACTS.

Activities of "New Preferred Stockholders' Committee."

At all times after 1937 C. L. Bradley and J. P. Murphy were asserting large claims against Higbee—claims aggregating over $1,500,000—based on certain promissory notes (referred to as the junior indebtedness) which they had purchased from George and Frances Ball Foundation for $600,000 at a time when Bradley was a director of Higbee. (R. 229.)

During the years 1938 through 1940, Respondents Potts and Boag were members of the "New Preferred Stockholders' Committee" and as such were objecting to the allowance of the claims filed by Bradley and Murphy on the grounds that the junior indebtedness was not a valid debt of Higbee, but should be considered a capital advance; or in the alternative that Bradley and Murphy should not be permitted to claim against Higbee for an amount larger than the purchase price to Bradley and Murphy of the junior notes (Young Ex. 1, R. 81, offered R. 10).

The extent of the controversy and the bitterness with which the divergent points of view were asserted appear in a brief which was filed by Potts and Boag, acting as

the New Preferred Stockholders Committee, on December 15, 1938 (Young Ex. 2, R. 88, offered R. 10). Messrs. Bradley and Murphy attacked the Potts group as not constituting a bona fide Committee. In defense of their position, the brief of the Committee stated:

> "This committee contends and expects to prove that these gentlemen (Bradley and Murphy) bought this claim for about thirty cents on the dollar during the reorganization proceedings and while in a fiduciary position towards the debtor and its Preferred Stockholders, thereby attempting to make a profit for themselves of $1,200,000 on the transaction." (R. 92.)
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> • • • • •
>
> "Mr. Fackler (attorney for Bradley and Murphy) wants a 'friendly' committee, a committee which he can handle, and a committee which will think not so much of protecting the rights of the Preferred Stockholders, but other interests as well. We do not represent any other interests and no individual member of our committee represents any other interests, and any such statement is false. No such testimony was submitted, and no such testimony could be submitted. If Mr. Fackler sees something yellow, it is due to his own jaundiced eye and not based upon any existing fact. Mr. Fackler makes the statement that our committee was organized for the purpose of 'hindering and obstructing' the reorganization. Not a shred of proof is in the record to support any such malicious statement. If this committee has hindered and obstructed anything at all, it has hindered and obstructed a scheme on the part of Mr. Fackler's clients, Charles L. Bradley and John P. Murphy, to make a profit of $1,200,000 on a transaction involving Mr. Bradley's own company, while seeking reorganization under the provisions of 77B of the Bankruptcy Act, to which profit we contend they are not in equity and good conscience entitled." (R. 93-4.)
>
> • • • • •
>
> "The committee contends that, under the scrutiny clause of the Reorganization Act, and supported by

other authorities, the very outside limit that should be allowed Bradley and Murphy on their claim is the consideration they actually paid for it." (R. 95.)

By December 18, 1940 Potts and Boag had resigned from the then existing stockholders' committee. On that day there was a hearing before the Special Master on the Amended Plan of Reorganization and at such hearing Potts announced to the court that he was forming a new stockholders' committee to continue objections to the Plan and to make an application to the court for the appointment of disinterested counsel, as he was then asserting that it was unfair to the preferred stockholders for counsel then acting for the Debtor to continue to do so in view of their reluctance to object to the Bradley-Murphy claims. On that occasion Potts stated to the Master as follows (Young Ex. 18, R. 185, offered R. 12):

"A new stockholders' committee will be formed, and whether or not we call it a new new stockholders' committee, I don't know, but it will have to be given some name so that we can differentiate it from the other stockholders' committee, and I think, after talking with Mr. Ewing, that the objections can be consolidated so that you will have to deal with just one committee in the very near future."

Activities of "Independent Preferred Stockholders' Committee."

Pursuant to the notification given to the Master, Potts and Boag organized the "Independent Preferred Stockholders' Committee." Immediately they filed an application for the appointment of special counsel and a brief in support thereof (Young Ex. 5, R. 112, offered R. 10, Ex. 6, R. 115, offered R. 10), urging that the apparent disinclination of the then attorneys for the debtor to object to the junior indebtedness claims of Bradley and Murphy disqualified them. In their brief on this question, Potts

and Boag, as the new Independent Preferred Stockholders Committee, stated the following:

> "The fact that Mr. Bradley has been a Director of The Higbee Company since 1933, and the fact that Mr. Murphy has been a Director of The Higbee Company since 1937, and the fact that Mr. Bradley has been President of The Higbee Company since September 1937, and no doubt as Chief Executive of said Company has had the power to retain and remove legal representation, have unquestionably influenced Attorney Abbott in his failure to resist in any respect the Junior Debt in the hands of Messrs. Bradley and Murphy." (R. 117.)

Respondents next filed objections to the Plan (Young Ex. 4, R. 104, offered R. 10) which were overruled by the Master. They then filed exceptions to the Master's action (Young Ex. 7, R. 121, offered R. 10) and thus continued their opposition to the allowance of the Bradley-Murphy claims and to the treatment thereof provided by the Plan.

A reply brief of Potts and Boag (Young Ex. 9, R. 146, offered R. 11) was submitted to the court in answer to the Debtor's brief which argued in support of the Master's report. This reply brief makes the following very significant statement (R. 147):

> "SECOND, it has been stated that objectors own and therefore represent only 260 shares of Higbee First Preferred. While we believe that the owner of a single share has as much right to be heard as the owner of many shares, we wish to point out to the court that objectors were originally members of the New Preferred Stockholders' Committee; that objectors resigned from said committee in protest over the unauthorized action of its counsel in approving this Plan. The representation which said New Preferred Stockholders' Committee now claims was acquired mainly through the presence on such Committee of Messrs. Potts and Boag, the present objectors, *and it is now a fact that a very large proportion of the stockholders which the New Preferred Stockholders' Committee*

claims to represent actually look to these objectors for the protection of their interest. The two remaining members of that committee are the owners of 10 shares of Preferred Stock each." (Emphasis added.)

On July 10, 1941 Potts and Boag sent a letter (Young Ex. 14, R. 172, offered R. 12) to all of the holders of First and Second Preferred Stock of The Higbee Company under the letterhead of "INDEPENDENT PREFERRED STOCKHOLDERS' COMMITTEE OF THE HIGBEE COMPANY." This letter merits careful examination. It begins with the following paragraph (R. 172):

> "The undersigned constitute a Committee organized solely for the benefit of the Preferred Stockholders of The Higbee Company, and to prosecute certain objections to the Amended Plan of Reorganization dated September 27, 1940, filed for The Higbee Company."

The letter then outlines in some detail the objections which were asserted by Potts and Boag to the Bradley-Murphy claim, and recites some of the accomplishments obtained by Potts and Boag on behalf of all preferred stockholders since filing the original objections. Near the close of the letter will be found the following paragraphs (R. 178):

> "If you desire any further information, please get in touch with this Committee. Without any obligation whatsoever, you may join in this fight to the finish, in order to get a better deal for the Preferred Stockholders of The Higbee Company.
>
> "This Committee is, and will remain, absolutely independent of the far reaching influences of The Higbee Company management. In case you do not approve this plan, we will be glad to have you so advise us."

Potts was examined at length concerning this letter by Mr. Sherwood of The Securities and Exchange Commission at the hearing on the application of Potts for compensation held May 14, 1942 (Young Ex. 19, R. 185, offered R. 12). It there appears that Potts received replies from

preferred stockholders to the letter of July 10, 1941, that some of the stockholders "expressed a desire that the objections be prosecuted" and that the stockholders were never given notice that Potts and Boag had discontinued their representation of the interests of the stockholders. Under these circumstances, and in view of the strong and unequivocable language of the letter of July 10, the preferred stockholders were entirely reasonable in their reliance upon the good faith of Potts, an attorney in the proceedings, who had expressed his intention to prosecute the objections to final conclusion. Even Potts was aware of this because he gave the following testimony upon interrogation by Mr. Sherwood (R. 187):

> "Q. As far as some of these people who wrote you were concerned though, they might reasonably have thought that the Independent Stockholders' Committee was still representing their interests and continuing in the course indicated in that letter of July 10?
>
> A. That might be true."

On October 2, 1941 Respondents filed objections and exceptions to the confirmation of the Amended Plan of Reorganization (Young Ex. 15, R. 178, offered R. 12). In these objections Potts and Boag continued in their position that the junior indebtedness should not be allowed in the hands of Bradley and Murphy for the amounts set forth in the plan. With these objections, Potts and Boag requested and received leave of the court to refile their briefs which had originally been filed in connection with the earlier objections to approval of the plan (R. 181). One of the briefs so refiled was that which is quoted above at page 8 wherein Potts and Boag claimed to represent "a very large proportion of the stockholders." Thus Potts and Boag were continuing to represent stockholders and to take advantage of this representation in any way that they could before the court.

After the judgment of the District Court on October 17, 1941 confirming the plan, Respondents filed notice of appeal (Young Ex. 16, R. 181, offered R. 12), and in the appeal continued their vigorous opposition to the allocation in the plan of the new notes and common stock to the old junior indebtedness claimed by Bradley and Murphy. This was not, however, the only ground for appeal.

As a part of the record on appeal Potts designated his statement made at the hearing of December 18, 1940 (Young Ex. 18, R. 184, offered R. 12) of which a portion was quoted *supra* on page 7. Thus Potts represented to the Circuit Court of Appeals that he was acting in a representative capacity in connection with the appeal on behalf of all stockholders.

Thus until the very sale of their stock Potts and Boag consistently held themselves out as being the champions of the rights of all preferred stockholders and as the actual representatives of a large number of them. This representation was made to the Master, to the District Court, to the Circuit Court of Appeals and to the preferred stockholders themselves.

The "Sale" of the Appeal by Potts and Boag.

Suddenly, however, Potts and Boag were confronted with an urgent desire upon the part of Bradley and Murphy to acquire the Potts and Boag stock. It became apparent that this stock had acquired a bargaining or nuisance value far in excess of intrinsic value. Potts and Boag could see great monetary gain to them if they could abandon the persons whom they were then representing and shift their position to that of individual litigants. After March 3, 1942 when the first contact was made by Bradley and Murphy, Potts and Boag quickly and without notice to any court or any shareholders shifted their position and asserted for the first time that they were acting in their individual interests and without regard for the

interests of any other stockholders. The shift was purely a mental one as there were no outward manifestations. The stockholders whom they had so fervently represented prior to that time were suddenly abandoned and the appeal was sold out without any notice whatever.

On March 7, 1942 Bradley and Murphy purchased from Potts and Boag their 260 shares of First Preferred Stock of the Debtor for a purchase price of $115,000. The approximate market value of the shares on that date was $15,000. The sale of the Potts and Boag stock to Bradley and Murphy was admittedly a sale of the appeal. A written contract of sale was executed (Young Ex. 26, R. 223, offered R. 13) which brazenly called for the purchase of the appeal in the following language:

> "I, (J. Fred Potts) hereby sell, assign, transfer and set over unto Charles L. Bradley and John P. Murphy, and their assigns, 260 shares of First Preferred Stock of The Higbee Company, of Cleveland, Ohio, 250 of which said shares are owned by me and 10 shares are owned by William W. Boag, whose attorney I am with full power to act on his behalf, together with all rights, title and interest, benefits or privileges we, or either of us, have or may have in and to or by virtue of or arising from the matter of The Higbee Company, Debtor, J. Fred Potts and William W. Boag, Appellants, vs. The Higbee Company, Appellee, and a certain appeal taken by J. Fred Potts and William W. Boag in said proceedings, which said appeal is now pending in the United States Circuit Court of Appeals for the Sixth Circuit * * *." (R. 223.)

Events Subsequent to the "Sale" of the Appeal.

The transaction was subsequently described in the testimony of Potts (Young Ex. 19, R. 188, offered R. 12) taken upon an examination by Mr. Sherwood of the Securities and Exchange Commission:

> "Q. Will you tell us the circumstances under which that appeal was dismissed?

A. Well, Mr. Boag's stock and the stock in my name was sold to Messrs. Bradley and Murphy.

Q. For how much was it sold?

A. I don't mind answering it, but I will answer it under objection because it is entirely immaterial.

The Master: I think it is material in this proceeding and I think you may answer. Objection overruled.

A. The total amount was $115,000.

Q. Was that paid in cash?

A. Most of it.

Q. How much of that amount was paid to Mr. Boag?

A. Twenty thousand dollars.

Q. And the balance to you?

A. Yes, sir. I want an objection and exception to all these questions.

Q. The total amount of stock that you and Mr. Boag sold to Mr. Bradley and to Mr. Murphy was 260 shares; is that correct?

A. That is correct.

Q. That would mean that it had a par value of $26,000?

A. That is correct.

Q. Have you any idea what the market value of it was at that time?

A. From sixty to sixty-five.

Q. Have you any idea what induced anybody to pay $115,000 for stock with a par value of $26,000 and a market value considerably less?

A. I think there was a desire to end this litigation.

Q. So that in a sense you were selling something more than your stock, I take it?

A. I think so.

Q. You were selling the appeal which you had taken in behalf of yourself and Mr. Boag; that is a fair statement, isn't it?

A. I think so.

Q. Was the appeal, that you and Mr. Boag took, a part of the program that was outlined to the preferred stockholders in your letter of July 10?

A. It might have been a part of it. The objections, I think, confirmed what we said we would object to.

Q. Were there any other people interested in buying this stock at the time that you sold it to Mr. Bradley and to Mr. Murphy?

A. No; I don't think so.

Q. Mr. Young wasn't interested?

A. Apparently not."

Potts desired to make an even greater profit out of his position in Higbee so he filed an application for an allowance of compensation upon the theory that he had performed a great service on behalf of all stockholders. It must be remembered that this was after the sale of his stock—and the appeal—to Bradley and Murphy but before anyone had suggested that he should account for the bonus he had theretofore received. At the hearing on his application, Potts was interrogated about the "Independent Preferred Stockholders' Committee" which he had theretofore formed. The following is an excerpt from his testimony (R. 185-6 and 188).

"Q. Now after you left the New Preferred Stockholders' Committee you formed another committee, didn't you?

A. I don't know as you could call it another committee. We didn't do anything about forming another committee until after the plan was approved, I think, July 2, 1941.

Q. What did you do then?

A. Sent out a letter to the stockholders.

Q. What was the letterhead?

A. Independent Stockholders' Committee.

Q. And the signature to that communication was also Independent Preferred Stockholders' Committee, wasn't it?

A. That is right.

Q. By whom?

A. Boag, Joecken and Potts.

Q. So that you represented at least that a new Preferred Stockholders' Committee had been formed, did you not?

A. That is right.

Q. What became of that committee?

A. Well, after the plan was confirmed Mr. Boag and Mr. Potts were the only ones that were willing to press our objections any further and that probably was the end of the committee other than whatever was left of it represented by Boag and Potts.

Q. Well, now, did you receive any replies to this communication that you sent out on the letterhead of the Independent Preferred Stockholders' Committee?

A. A few, yes.

Q. Did any of the stockholders who replied express any interest in having this committee represent them?

A. Well, some of them expressed a desire that the objections be prosecuted.

Q. Were they ever given any notice that this committee had been dissolved?

A. No; they weren't."

* * * * *

"Q. Was the appeal, that you and Mr. Boag took, a part of the program that was outlined to the preferred stockholders in your letter of July 10?

A. It might have been a part of it. The objections, I think, confirmed what we said we would object to."

At that hearing Mr. Sherwood of the Securities and Exchange Commission stated the position of the Commission as follows (R. 192):

"It is perfectly plain from Mr. Potts' testimony that he was not only selling the stock, he was selling an appeal, and it can be drawn from that testimony that other people than Mr. Potts and Mr. Boag were interested in that appeal. Whether we call it a class action, anything that resulted from that appeal, except selling it in this way, would have inured to the benefit

or the detriment, however it might work out, of the whole class of stockholders.

"I don't think that this Court should be called upon to approve a transaction involving the sale of an appeal, which is what, to a substantial extent, this amounts to. It was also, of course, a sale of stock. It seems to me that where others are interested in an appeal the sale of the appeal in that way is an unconscionable action.

"One other thing. The action of the Circuit Court of Appeals in dismissing this appeal does not necessarily force the conclusion that the Court concluded that it was an individual appeal and that others were not interested in it. * * * Under these circumstances, it may well be that in some other Court, at some other time, some or all of the preferred stockholders, including those who may have thought that Mr. Potts, in sending out a letter on the letterhead of the Independent Preferred Stockholders' Committee, was representing their interests, have some right to an accounting for what Mr. Potts cleared in this transaction over and above the fair value of the stock that he sold."

The Master also expressed his views in his report recommending denial of any compensation to Potts, and denial of an application which Potts had filed requesting approval of the sale to Bradley and Murphy (Young Ex. 20, R. 194, 195, offered R. 13):

"The testimony of Potts is that he did not consider the sale price of his stock to contain any compensation for services rendered by him in the proceeding, although such recovery was realized in the course of the settlement of the appeal. In such recovery the preferred stockholders, including those who responded to his appeal for support, have not shared although obviously they would have shared in any benefits which might have accrued if the appeal had been successfully prosecuted to a conclusion."

Potts took exceptions to the report of the Special Master recommending denial of compensation (Young Ex.

21, R. 198), and in his brief in support of the objections and exceptions (Young Ex. 22, R. 199, offered R. 13) he reverted once again to his contention that he was representing the interest of all of the preferred stockholders. Thus he says in his brief (R. 203):

> "Applicant J. Fred Potts fought for the above amendments and we submit that those accomplishments which inured to the benefit of all the First Preferred Stockholders, don't reflect that Mr. Potts was looking after his own interests alone. We don't deny that Mr. Potts was looking after his family's interest in Higbee. He spent his own money and gave of his time freely for several years as a member of the New Preferred Stockholders Committee without the slightest hope of being reimbursed or compensated, and that is more than can be said for Messrs. Bloomfield and Orr who now accuse Potts of having had nobody's interest at heart but his own."

Thus, even *after* the sale of his stock (and of the appeal) at an exorbitant profit, Potts was still claiming to be the champion of the interest of preferred stockholders other than himself.

Potts' application for compensation from the Debtor's estate was disapproved for the reason, among others, that the sale of his stock had not been approved by the court as was required by Chapter X, Section 249 of the Bankruptcy Act. Thereupon Potts filed an application for approval of the sale to Bradley and Murphy and the Master also recommended that this be denied (Young Ex. 20, R. 194, offered R. 13).

The Securities and Exchange Commission filed a memorandum with the District Court opposing the applications of Potts for compensation and for approval of the sale to Bradley and Murphy (Young Ex. 24, R. 216, offered R. 13). The District Court filed its memorandum on September 3, 1942 adopting the recommendations of the Master and thus refused to allow Potts any compensation or to approve the

sale of the Potts and Boag stock to Bradley and Murphy. The Court, after reciting the facts of the sale, stated the following (Young Ex. 25, R. 221, offered R. 13):

> "There is no justifiable basis in these circumstances upon which the Court could bottom its approval of the settlement sale of this stock, nor does there appear any just reason for allowing compensation to these applicants. * * *"

DISCUSSION.

The foregoing constitute the essential facts which should be considered by the court in this case. The Master went far outside of the record in his discussion and in his findings, most of which are irrelevant to the question of whether Potts and Boag are or are not entitled to keep the bonus they received when they sold out the interests of the hundreds of Higbee preferred stockholders.

It has been demonstrated above that Potts and Boag stated to all concerned that they were acting on behalf of stockholders generally and not just for themselves. The very nature of their objections was such that had they successfully litigated them to conclusion, the benefits would have inured to the Debtor and all preferred stockholders. The principal objection asserted was that the Bradley-Murphy claim either be eliminated as an indebtedness or greatly reduced. Obviously the Debtor would have benefited by the reduction in its total debt which Potts and Boag were endeavoring to bring about.

In this respect the situation is analogous to a stockholder's suit wherein a single stockholder sues to recover assets which he claims rightfully belong to the corporation. This type of suit can be brought only in the interest of the corporation whether or not the stockholder bringing it purports to be acting alone or in a representative capacity.

As was stated in *Alexander v. Quality Leather Goods Corp.*, 269 N. Y. Supp. 499 (Sup. Ct. N. Y. 1934):

> "When a minority stockholder brings an action on behalf of himself and on behalf of other stockholders similarly situated, he exercises a derivative right and judgment must ordinarily be rendered in favor of the corporation, though the corporation be a defendant in the action."

Similarly in *Curtiss v. Wilmarth*, 254 Mich. 242, 236 N. W. 773 (Sup. Ct. Mich. 1931), the court discussed the nature of an action by a stockholder saying:

> "A suit by a stockholder is in fact a suit by the corporation to redress a wrong to the corporation, and the relief granted belongs to the corporation and not to the stockholder individually. He is not entitled to the money recovered. That goes to the corporation and not to the individual complainants."

In *Planten v. National Nassau Bank of New York*, 174 App. Div. 254, 259, 160 N. Y. S. 297, 302 (affirmed in *Planten v. Earl*, 220 N. Y. 677, 116 N. E. 1070), the Court discussed the rights of stockholders to bring actions for the benefit of the corporation and stated:

> "When, however, a proper foundation is laid for such an action, the control of the litigation becomes vested in the shareholder who brings it and such others as may join therein, although the cause of action belongs to the corporation and *the fruits of the litigation inure to its benefit.*" (Italics added.)

In *Dean v. Kellogg*, 292 N. W. 704 (Sup. Ct. Mich. 1940), the Court discussed the nature of the case as follows:

> "In the usual stockholders' derivative suit, the stockholders as plaintiffs are permitted to instigate the action in a court of equity to enforce a claim of the corporation. *Foss v. Harbottle*, 2 Hare's Ch. 461, 67 Eng. Rep. 189; *Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827. Any recovery runs in favor of the corporation, for the shareholders do not sue in their own right.

Talbot v. Scripps, 31 Mich. 268; *Horning v. Louis Peters & Co.*, 202 Mich. 140, 167 N. W. 874; *Curtiss v. Wilmarth*, 254 Mich. 242, 236 N. W. 773. They derive only an incidental benefit."

An additional factor is significant here. Bradley and Murphy were in control of the policies of the Debtor. They were also asserting large claims against it. Debtor's attorneys never filed objections to these claims although Potts and Boag, as members of a preferred stockholders' committee, did so as early as 1938. Potts and Boag bitterly complained of the failure by Debtor's attorneys to file appropriate objections, thus admitting that the objections should properly be made on behalf of the Debtor and its preferred stockholders.

Bradley and Murphy as claimants to the junior indebtedness were interested in a plan of reorganization which would give them the largest participation possible in the reorganized company. Similarly the preferred stockholders were interested in obtaining as large a participation as possible. The plan provided for $600,000 of notes and the majority of the common stock to go to the junior indebtedness. Bradley and Murphy paid members of a preferred stockholders' committee a bonus of $100,000 in order to see this plan go through. Perhaps the parties to the transaction felt that they could avoid scrutiny because representation of stockholders generally in matters of this kind is less definite and concrete than the usual representation by an attorney of a single party litigant. However, for that very reason, if for none other, the court should more closely scrutinize the transaction so that the rights of the poorly represented stockholders will be amply protected. The making of a deal of this kind with the attorney and representative of stockholders is no less subject to criticism and appropriate court action than would be a payment by a litigant to the attorney for his individual adversary to cause the attorney to discontinue the litigation.

If the proceeds of the Potts and Boag appeal would have inured to the Debtor and its First Preferred Stockholders then the proceeds of the settlement of that appeal should likewise inure to the benefit of the Debtor and its First Preferred Stockholders. There is no logical distinction between the proceeds of the litigation itself and the proceeds of the settlement of litigation. A decree directing Potts and Boag to turn over the $100,000 bonus is the proper remedial device.

The instant case is a flagrant example of misconduct. Potts and Boag were members of two committees They solicited the right to represent all stockholders (R. 172-8). They urged upon the court that they represented stockholders generally. They urged meritorious objections to the plan on behalf of all stockholders. Bradley and Murphy paid the price for settlement, knowing full well that the payment would remain in the pockets of Potts and Boag and would not reach those they represented by any voluntary route. This case presents an opportunity to this Court to condemn this trafficking in litigation with all of its ramifications and the inherent evils which arise as a result of the possibility of such conduct. To permit a sale of an appeal under these circumstances, and thus create a precedent, would be a serious blow to the subsequent fair and ethical conduct of corporate reorganization proceedings.

Even more serious is the instant situation where the payment was made in such a manner that a final adjudication resulted, thus preventing any other security holder from presenting the matter for a judicial determination. Respondents appealed from a judgment of the District Court. After the time within which any others could bring an appeal the payment was made under a contract (R. 223) which specifically provided for the dismissal of the appeal. To the knowledge of all parties concerned, no appeal by any other was then possible. Thus did the matter result

in a final adjudication without any hearing on the merits. Surely under these circumstances the preferred stockholders are entitled to the proceeds of the settlement of the litigation brought on their behalf.

It is clear that the members of a stockholders' committee owe fiduciary obligations to the stockholders they represent. In 15 *Fletcher's Cyc. of Corps.* 411, the subject is discussed as follows:

> "In reorganization proceedings committees are usually appointed, and while their powers are, as a rule very broad, their chief functions are to gather the stock or other securities, represent the owner in the reorganization, and prepare the plan of reorganization. *Their duties and obligations are of a fiduciary nature.*" (Italics added.)

Similarly, at page 415 Fletcher says:

> "As fiduciaries for all the parties beneficially interested, the members of the committee must, in the execution of their trust, deal fairly and equitably, and are not entitled to use their position for personal profit."

Similarly, in *Parker v. New England Oil Corp.*, 4 Fed. 2d 392, 395 (Dist. Ct. Mass. 1924) the Court discussed the nature of the duties of stockholders' committees as follows:

> "It is not desirable, probably not practicable, now to undertake to define exactly the nature and extent of their powers and duties. It is enough, for present purposes, to characterize them under the general term of fiduciaries. * * * They had the general rights and powers, and were subject to the general obligations and limitations, of trustees. They could not, of course, trade with their trust estate to their own profit or otherwise use their position for personal profit."

In *Mann et al. v. Commonwealth Bond Corp.*, 27 Fed. Sup. 315 (Dist. Ct. S. D. N. Y. 1938), the Court, in the head note, holds that:

"A reorganization committee must devote such moneys as come into its hands to the purposes of the trust and reorganize as well as possible the company involved."

See also *Trustees Corporation, Ltd. v. Kansas City, M. & O. R. Co.*, 18 Fed. 2d 765 (C. C. A. 8th, 1927).

It will be argued by respondent Potts that at the time he sold his stock he was not acting for the stockholders, and he will point to the Master's findings in support of this position (Finding 18, R. 242). See also order of Circuit Court of Appeals (R. 265).

Petitioner agrees that, as the matter turned out, a finding that Potts and Boag were actually acting only for themselves is fully warranted. Had they been acting for those whom they stated they represented, they would have turned over the proceeds of the sale of their appeal for distribution among all the members of the class.

It cannot be disputed, however, that Potts and Boag openly, although apparently in bad faith, held themselves out to be a committee organized for the protection of the preferred stockholders of Higbee. They made statements to this effect in briefs and pleadings filed with the District Court and they circularized the preferred stockholders with letters under the letterhead of "Independent Preferred Stockholders' Committee of The Higbee Company." (R. 172.)

There appeared to be a change of character. At one moment Potts and Boag represented themselves to be acting in a capacity which, as is demonstrated above, involves fiduciary obligations to stockholders. The next moment Potts and Boag were acting solely for themselves. Surely as fiduciaries they were obligated to advise those whom they represented that they, Potts and Boag, were no longer acting in a representative capacity. But as to this, Potts testified (R. 187):

"Q. But you hadn't told any of the preferred stockholders, that had written in to you regarding the Inde-

pendent Stockholders' Committee, that you were no longer representing their interest; is that true? A. No; I don't think we did. We didn't have any more communication at all, unless it was by telephone or somebody called up, or we called somebody up, or some stockholders called us up. The results of the money spent didn't justify many more communications going out.

"Q. As far as some of these people who wrote you were concerned though, they might reasonably have thought that the Independent Stockholders' Committee was still representing their interests and continuing in the course indicated in that letter of July 10? A. That might be true."

Potts and Boag should be estopped from relying in this case upon their undisclosed change of position. The stockholders were entitled to rely upon the representations which Potts and Boag had made, at least until notice to the contrary was given to them.

The obligations of Stockholders' Committee and their position in corporate reorganization proceedings were discussed in *Steere v. Baldwin Locomotive Works*, 98 Fed. 2d 889 (C. C. A. 3rd, 1938), where the court said:

"In the case of most corporations requiring reorganization the holdings of many security holders are too small to make possible independent action for their own protection. This has brought about the formation of committees for their protection. The history of corporate reorganizations before the adoption of Section 77B reveals too many instances of committees, often self constituted, formed ostensibly to protect security holders but actually serving their own or other private interests at the expense of those they were appointed to serve. One of the purposes of the Bankruptcy Act as amended is to assure such security holders that, so far as the court is able to ascertain after hearing, any committee permitted to intervene in their behalf is composed of able and honest individuals who are free of conflicting interests and reasonably representative,

> and may, therefore, reasonably be expected adequately to protect their interests. The act seeks to assure such representation by authorizing such committees to be adequately compensated out of the debtor corporation's estate for constructive services rendered in assistance of the formulation and accomplishment of a fair and reasonable plan of reorganization. It should be administered in the light of these underlying purposes."

Surely the rule as stated in the *Steere* case is a most salutary one. Widely distributed security holders must look to the court for guidance and protection.

Whatever may be said about the sudden change by Potts and Boag in the role they were playing in this litigation, it seems clear that the payment by Bradley and Murphy and acceptance of payment by Potts and Boag of money for the "sale" of an appeal skirts dangerously close to, if it does not transgress, the prohibition of Section 29b(5) of the Bankruptcy Act which provides as follows:

> "b. A person shall be punished by imprisonment for a period of not to exceed five years or by a fine of not more than $5,000, or both, upon conviction of the offense of having knowingly and fraudulently * * * (5) received or attempted to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof from any person, for acting or forbearing to act in any proceeding under this Act;"

Acceptance of the payment for forbearing to prosecute the appeal in the bankruptcy proceeding and retaining the funds is the act of which complaint is here made. Potts and Boag should not be permitted to retain the fruits of a transaction of this character.

STATEMENT REGARDING WILLIAM W. BOAG.

During the course of the appeal in the Circuit Court of Appeals it first came to Petitioner's attention that Respondent Boag had entered the Armed Services. No one representing Boag has appeared to request a stay of proceedings pending his return. However, Petitioner has no desire to cause judgment to be entered against Boag under these circumstances. It would be entirely satisfactory to have the proceedings stayed as to Boag pending his return, although no rights against him are waived.

No similar disability exists respecting respondent Potts who was the major participant in the transaction, owning 250 shares, compared with 10 shares owned by Boag. Potts negotiated the agreement of March 7, 1942 (Young Ex. 26, R. 223, offered R. 13) for the sale of the stock, both on his own behalf and acting for Boag. Under these circumstances, Potts is responsible for the entire profit made in the joint venture. *Jackson v. Smith*, 254 U. S. 586, 41 S. Ct. 200.

CONCLUSION.

Wherefore, Petitioner, Robert R. Young, a holder of the preferred stock of The Higbee Company, respectfully prays that this Court reverse the judgments of the Courts below and direct the payment over by the respondent, J. Fred Potts, to The Higbee Company for its preferred stockholders of a sum equal to the difference between the fair value of 260 shares of First Preferred Stock of The Higbee Company on March 7, 1942, and the amount ($115,000) paid therefor by Messrs. Bradley and Murphy —the amount of such difference to be determined by the Special Master below—together with interest on said sum, and that Petitioner be awarded the costs and proper disbursements made by Petitioner in all Courts, together with

such other relief as to this Honorable Court may seem just and proper.

Respectfully submitted,

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